

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 98-0086 ST
Sales And Use Tax
For Tax Periods: 1994 Through 1996

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ISSUES

1. Sales and Use Tax-Labels

Authority: IC 6-2.5-5-6

Taxpayer protests the assessment of additional tax on adhesive labels.

2. Sales and Use Tax-Display Stands

Authority: IC 6-2.5-3-2, IC 6-2.5-3-1(b), Miles, Inc. v Department of State Revenue N.E. 2nd 1158 (Ind. Tax Court 1995).

Taxpayer protests the assessment of additional tax on display stands given to retailers.

3. Sales and Use Tax-Safety Equipment

Authority: 45 IAC 2.2-5-8 (c) (2) (F)

Taxpayer protests the assessment of additional tax on safety equipment used in the manufacturing process.

4. Sales and Use Tax-Services

Authority: IC 6-2.5-4-1, IC 6-2.5-2-1, 45 IAC 2.2-4-2 (a)

Taxpayer protests the assessment of tax on the creation of a web page.

5. Sales and Use Tax-Law Labels

Authority: IC 6-2.5-5-6

6. Sales and Use Tax-Print Shop Supplies

Authority: IC 6-2.5-3-2(a), Gross Income Tax Division v. National Bank and Trust Co., 226 Ind. 298, 79 N.E. 2nd 651 (1948), IC 6-2.5-5-3

Taxpayer protests the assessment of additional tax on certain print shop supplies.

Statement of Facts

Taxpayer is a corporation which manufactures two distinct product lines: (1) juvenile products, such as car seats, cribs, toddler bed frames, and a variety of other products; and (2) household furniture, such as step stools, card tables, carts and related products. The various product lines are integrated so that one production line may fabricate the raw material for another production process. Taxpayer holds a direct pay permit with the Indiana Department of Revenue and accrues a flat amount of use tax per month endeavoring to cover all taxable purchases. A separate list of purchases is also kept that states the items that are known to be taxable. This known amount is added to the estimated flat amount and the total is remitted. Taxpayer filed a claim for refund for the use tax that was overpaid for the years 1995 and 1996. This overpayment resulted because the amount of the estimated use tax that was remitted became inflated in 1995. The amount claimed in refund was based on an analysis of two months of accounts payable distribution for that month to determine a taxable percentage for each account. The resulting percentage was then applied to the applicable accounts payable 1996. Since the claim for refund amount was based on a projection, an audit of Taxpayer's entire purchases was conducted to arrive at the correct amount of use tax that was due during this period. All taxable purchases were listed and credit was given for all use tax remitted. Taxpayer protested the assessment of use tax on several items in the audit. Further facts will be provided as necessary.

Discussion

1. Sales and Use Tax-Labels

Taxpayer's first point of protest concerns the assessment of use tax on certain labels. Pursuant to IC 6-2.5-5-6, transactions involving tangible personal property are exempt from the state gross retail tax if the purchaser acquires it for "incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business." Taxpayer's adhesive labels include a picture and description of the product, required information about the product for consumers such as style and color and product specifications such as size and shape. These labels are affixed to the box containing the individual products in the last stage of the production process and actually become a material part of the finished product. The retail outlets that sell the products to the ultimate consumers require these labels. Without these labels, consumers would need to open each individual box

at the retailers' stores to determine which product to purchase. Any box opened for inspection and subsequently not purchased would be unmarketable because consumers refuse to purchase Taxpayer's product if it is not in a sealed container. The subject labels clearly fit this exemption.

Finding

This point of Taxpayer's protest is sustained.

2. Sales and use Tax-Display Stands

IC 6-2.5-3-2 imposes the use tax "on the storage, use, or consumption of tangible personal property in Indiana." IC 6-2.5-3-1 (b) defines "storage" as "the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana. Taxpayer purchases pop up display stands that are given away to vendors located in Indiana and various other states. These display stands are basically miniatures of Taxpayer's products that have been assembled and put on display at the retail locations so that potential customers can view the product. These displays are forwarded to Taxpayer's representatives throughout the United States who in turn give them to Taxpayer's retailers for use in their stores. According to Miles, Inc. v. Department of State Revenue, 659 N.E. 2nd 1158 (Ind. Tax Court 1995), a manufacturer's temporary storage or promotional materials in its Indiana warehouses for subsequent shipment outside the state does not constitute a taxable "storage" or "use" for purposes of imposing Indiana use tax. Since the display stands are temporarily stored in Indiana for ultimate use outside the state, only those given away and used by Indiana vendors are subject to tax.

Finding

Taxpayer's protest as to the display stands used outside of Indiana is sustained.

3. Sales and Use Tax-Safety Equipment

Taxpayer regularly purchases safety equipment such as duct sleeves, gloves, shoes and glasses that are worn by its employees during the production process. According to 45 IAC 2.2-5-8 (c)(2)(F), safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production is exempt from tax. Taxpayer protests the assessment of tax on certain items of safety equipment.

In the Tubing Department, employees handle metal tubes that are cut, shaped and deburred prior to their incorporation into the product. Without the safety gloves and glasses, workers would suffer cuts and eye injuries during the cutting, grinding and deburring of the tubes. Accordingly, these safety items are necessary for the workers to participate in the production process without injury.

Workers also wear safety gloves and glasses in the Press Department. Workers in this area primarily handle sheet metal that is cut to smaller pieces for incorporation handle sheet metal that is cut to smaller pieces for incorporation

into products. The workers in the press area are also responsible for drilling holes in the tubes that are produced in the tubing area. The drilling of these holes allows for the final product to be assembled properly in another part of the production facility. Accordingly these safety items are necessary for the workers to participate in the production process without injury.

Workers in the Powder Coating Department wear duct sleeves. These workers are responsible for painting and baking the metal tubing received from the Press Department. Once the tubes have been powder coated, the tubes are inserted over pins on a baking rack so the tubes are vertical to the rack itself. Once the rack is completely loaded with the coated tubes, it is placed in an oven and baked at 80 degrees. After the baking process is completed, the racks are removed from the oven and the tubes are allowed to cool enough to be handled without causing burns. The racks, however, retain enough heat to cause injury if they come into contact with the workers' arms. Employees wear the sleeves to prevent burns if they accidentally touch the racks while removing the tubes. Accordingly, these safety items are necessary for the workers to participate in the production process without injury.

Finding

Taxpayer's protest to the assessment of additional use tax on certain safety items is sustained.

4. Sales and Use Tax-Law Labels

In 1996 Taxpayer purchased "Do Not Remove Under Penalty of Law" tyvek labels that are sewn into some of Taxpayer's products. IC 6-2.5-5-6 provides that transactions involving tangible personal property are exempt from the state gross retail tax if the person "acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business." These labels are sewn directly into the seams of Taxpayer's products and clearly become a material part of the finished product.

Finding

This point of Taxpayer's protest is sustained.

5. Sales and Use Tax-Print Shop Supplies

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., 226 Ind. 298, 79 N.E. 2nd 651 (1948). IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication, of tangible personal property." During the audit, it was determined that Taxpayer used 32.66 % of the printing and press supplies to produce items subject to tax.

This percentage has been applied to several items used by Taxpayer's print shop such as printers ink and paper but has not been applied to certain items that are used in the printing process and Taxpayer contends qualify for the directly used in direct production exemption. These items include film, photo supplies, color separations, and color negatives. The film, photo supplies and color negatives are used prior to the printing process. Therefore they are pre-production and do not qualify for exemption. The color separations actually are used in the printing process. These separations are between the ink and paper and allow the ink to color only the portions of the printing process that it is supposed to color. They directly affect the final printed product during the printing process. The color separations qualify for exemption because they are directly used in Taxpayer's direct production process.

Finding

Taxpayer's protest to the assessment of additional tax on color separations is sustained. Taxpayer's protest to the assessment of additional tax on the other items is denied.